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Contribution to Sitrep
19 March 85

Yugoslavia

On 14 March the Yugoslav Federal Assembly formally endorsed a draft agreement with the IMF for a 1985-86 standby credit of $300 million, opening the way for rescheduling of $5.7 billion debt due in 1985-88 by Western banks and governments. Yugoslav Federal Secretary for Finance Vladimir Klemencic characterized the talks leading up to the agreement as hard and complex but generally consistent with Yugoslavia's own economic policies. Perhaps in response to criticism that Yugoslavia yielded to overly austere terms, Klemencic noted that many of the Fund's targets were less restrictive or less binding than Belgrade's own economic resolutions adopted in late December 1984. 25X1

Under the new agreement, the GOY is to continue movement toward establishing real domestic interest rates, devaluation of the dinar to offset inflation, and tight control over domestic credit and government expenditures. The IMF, however, agreed to a new formula for computing the inflation rate used as the basis for establishing positive real interest rates. As a result, Belgrade will not have to raise domestic interest rates as much to meet its program target. 25X1

A meeting with the "Friends of Yugoslavia" creditor governments is scheduled for 25 March at which time the GOY is expected to continue to press for a multi-year rescheduling 25X1

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agreement (MYRA). Despite Belgrade's efforts, most key Western governments are expected to remain opposed to any MYRA in 1985. A second round of meetings is scheduled for the week of 20 May. Rescheduling talks with Yugoslavia's commercial bank creditors are expected to take place in mid-April. [redacted] 25X1

[redacted] 25X1

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Poland

Rescheduling negotiations with the Paris Club on 4-5 March came to an impasse because of the Polish failure to pay all creditors the late interest charges due on the 1981 rescheduling agreement. The creditors were particularly surprised over Warsaw's refusal to make these payments to the West Germans since their bilateral agreement clearly specifies a formula to calculate late interest. Although many delegations were reluctant to break off talks at this stage, the Paris Club did agree to support the FRG in its attempt to receive full payment and the broader point that Warsaw must honor explicit terms of contracts. The Polish negotiators decided to refer the decision on payment of late interest back to Warsaw. Discussions with the Poles on rescheduling of 1985 debt did not take place although general terms were discussed among the creditors. The next Paris Club meeting is scheduled for the week of 22 April on the condition that the Poles resolve the problem of late interest payments to the satisfaction of the creditors. [redacted] 25X1

Paris Club creditors continued to show no interest in offering the Poles new credits because they view the country as "manifestly uncreditworthy". Warsaw, however, has made it clear to creditors that Poland would be unable to meet its commitments without new credits. The regime is counting on at least $850 million in new loans from government creditors to meet the almost $3 billion in debt service due this year. Warsaw recently requested new credit lines from at least 13 Paris Club members--

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mostly in the range of 50 to 60 percent of their annual exports to Poland. The Polish government's request for 1985 included $450 million from West Germany, $240 million from Great Britain, and $130 million each from Canada and Italy as well as higher amounts in 1986. A specific amount was not requested from the US. The Poles would import mainly cereal and fodder, chemicals, metallurgical equipment, and machinery and spare parts with these credits. [redacted]

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The Polish request for new credits has caused major differences between the West German Ministries of Economics and Finance, [redacted] FRG Economic Minister Bangemann hoped to reopen Polish access to Hermes guaranteed credits for up to 100 million DM during his 21-22 March trip to Warsaw as head of the West German-Polish Mixed Economic Commission. The Finance Ministry, however, opposed the move ostensibly on grounds that the FRG is legally restricted by budgetary law from renewing Polish access to these credits until rescheduling negotiatons are completed. The Finance Ministry was also worried that if Bonn relaxed its restrictions and granted even a small amount of concessionary credit, the Poles would apply heavy pressure on the West German government for additional credit. [redacted]

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An IMF technical team held talks with Polish officials last month as the first step in processing Warsaw's application to rejoin the organization, but many Western financial experts doubt Poland will enter the Fund before year's end. The delegation--

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the first to visit Warsaw officially since the US lifted its sanction against membership--examined Polish economic data. While finding data on the balance of payments to be generally in line with IMF practices, the experts recommended changes in some domestic economic calculations. Another team is scheduled to arrive in Warsaw in mid-April to examine the current economic situation and plans to have a wide range contacts, including meetings with plant managers and union officials. [redacted] 25X1

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East Germany

A surge of medium-term borrowing has bolstered East Germany's financial strength, giving East German economic managers greater flexibility than they have enjoyed in years. Since last June, East Berlin has raised about $1.4 billion in seven untied credits of four to seven years' maturity on increasingly favorable terms, after several years of being excluded from the medium-term market. The last two credits--$400 million in December and $500 million this month--were increased from $150 million due to heavy oversubscription. The Bank for International Settlements reports that by 1 October--before the most recent five loans--East German assets at reporting banks reached $4.6 billion, well in excess of its normal liquidity needs. [redacted] 25X1

We believe East Berlin probably wants most to reduce its vulnerability to any sharp cutback in bank lending of the sort that nearly forced a liquidity crisis in 1982/83 and necessitated painful domestic adjustment measures. We expect East Germany to seek more medium-and long-term credits, using the proceeds to reduce its still considerable short-term debt as it runs current account surpluses to gradually reduce overall debt. We doubt reserves will grow much more. At the same time, East Berlin could be taking advantage of its improving creditworthiness to reduce interest expenses and forge closer links with some Western banks. East Berlin also may be marshaling its financial strength for boosting imports of capital goods to make up for the decline

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in investment in recent years. Any significant increase in purchases probably awaits completion later this year of East Berlin's foreign trade and domestic economic plans for 1986-90. We do not, however, expect it to run large hard currency trade deficits as in the 1970s. [redacted] 25X1

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Distribution:

1. [redacted] EURA/EE/EW

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1. [redacted] EURA/EE/NE

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1. [redacted] EURA/EE/SE

1 [redacted] EURA/EE/NE/ 25X1

4. IMC/CB (7G07)

2. EUR/PS (one is a sourced copy)

2. EW Branch Files

1. EW Chrono File

--original [redacted] OGI (requestor) 25X1

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